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JAPAN'S SLEEPING INSURANCE GIANTS: ROUSED AND READY?

SUMMARY

Japanese insurance companies are international financial giants but largely overlooked, especially outside Japan. They have served as a destination for a portion of Japan's large pool of savings and as a factor in capital markets, roles that in recent years have increased substantially and had spillover effects on foreign markets.

Competition is minimal in the Japanese insurance industry, which arguably enhances the importance of keiretsu, Japan's large corporate groups, in the distribution of insurance products. New insurance products and regulatory changes have increased the amount of competition in the market, however.

For various reasons American and other foreign insurance companies play a small role in the Japanese market. The industry's unusual structure, great size and minimal foreign market share have attracted the attention of American and other foreign trade negotiators, but the prospects for an early international agreement that would cover insurance and other financial services are uncertain at best.

The Japanese Insurance Industry in an International Context

In many respects insurance is the Rodney Dangerfield of industries: it doesn't get any respect. While most households and firms are users of insurance products in the United States and Japan, few people in either country know much about the companies from which they are buying the product. Yet, the industry is a giant in both countries. In the United States employment was an estimated 536,000 in 1991, twice the size of the automotive manufacturing industry and two-thirds the size of the automotive parts industry. In Japan the industry employed 699,000 people in firms of five or more employees as of December 31, 1990, the most recent year for which data are available. That figure was roughly two-thirds the number in automotive and automotive parts manufacturing and also comprised a substantially larger number relative to national population than in the United States. Despite these numbers, Maurice Greenberg, the chairman of the U.S.-based insurer doing the most

business in Japan — American International Insurance Group, Inc., got far fewer headlines as a result of accompanying President Bush to Japan in January than did the chief executives of the Big Three automotive makers.

One reason insurance companies get little publicity is their ownership structure. Stock market guides and business magazines say little about them because many Japanese and American insurance companies have no stockholders; instead, these insurers are mutual companies technically controlled by their policyholders. Most households might well be amazed to realize that by buying insurance policies from companies like Nippon Life Insurance Co. and State Farm Insurance Co. they gain the right to participate in corporate decisionmaking. This right rarely is exercised in either the United States or Japan, however.

In addition, industries in both countries keep low profiles in other ways. Befitting its status as a neglected giant of the financial world, State Farm, despite having nearly twice the capital of Merrill Lynch & Co., has its corporate headquarters in Bloomington, Illinois, far from the madding Wall Street crowd and some distance even from LaSalle Street, Chicago's counterpart to Wall Street. Nippon Life, the world's largest insurance company as measured by assets, traditionally has had its home office in Osaka, Japan's version of a "second city," although it now has headquarters in Tokyo as well.

Law and tradition divide the insurance industry in Japan into life and nonlife insurance. Life insurance companies sell products that are varying combinations of long-term savings vehicles and term insurance against a policyholder's death or serious illness. Nonlife insurance companies, which engage in a narrower range of businesses than their property and casualty American counterparts, insure against losses from automobile accidents, fire and other misfortunes. Japanese writers sometimes simplify the identification by saying that life insurance companies insure people and nonlife companies insure things. Each type of insurance company in Japan is prohibited from entering the other business. Both types offer insurance policies to individuals as well as corporations.

Although Japan has a significantly smaller population or gross national product than the United States, its life insurance market is larger. In 1989, the latest year for which comparable data are available, premiums equaled $199 billion in Japan versus $188 billion in the United States, the world's second-largest market. In contrast, nonlife insurance was much larger in this country at $265 billion against $66 billion in Japan, where insurers nosed out their West German counterparts for second place. To a significant extent Japan's enormous life insurance market reflects the use of life insurance as a savings vehicle. In fact, as will be explained below, even nonlife insurance companies in Japan have developed ways of competing for the nation's large pool of savings.

Table 1 shows the significant role that Japanese insurance companies play in the Japanese economy as measured by total operating funds. While commercial banks collectively are far bigger, life insurance companies are fewer in number, with the result that assets per institution are larger at life companies. As a group nonlife insurance companies have a far smaller role as holders of assets, but per institution they still are relatively large in this regard. Table 1 also shows several clear trends. In the early postwar years insurance companies played a more limited role than they did in 1934 and banks had a larger one. Since at least the 1970s, however, both types of insurance companies have been gaining ground vis-a-vis banks to the point that in 1990 insurers had a larger share of total operating funds than in 1934 while the bank share had declined sharply. Two government-related institutions — the savings portion of the Trust Fund Bureau (in effect, the postal savings system) and the postal life insurance (*Kampo*) and pension systems — also have gained ground on banks in terms of operating funds since the 1970s. The relative importance of the Trust Fund Bureau, however, has

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Table 1: **Role of Banks, Insurance Companies and Other Financial Institutions in Japan's Financial Markets, 1934-90**

(percentages of total operating funds in all financial sectors)

	All Banks	Shinkin	Shoko Chukin	Norinchukin	Agricultural Cooperatives	Insurance Companies			Trust Fund Bureau	Postal Funds	Other
						Life	Nonlife	Total			
1934	63.9%	0.8%	0.0%	0.8%	5.0%	9.0%	1.9%	10.9%	14.7%	3.8%	0.0%
1955	65.1	4.0	0.8	2.2	5.3	2.4	1.1	3.5	11.6	3.3	4.2
1960	65.2	5.0	0.9	1.5	4.4	3.7	0.9	4.6	10.3	3.7	4.3
1965	61.4	6.4	1.0	2.6	5.0	4.3	0.8	5.1	9.7	2.5	6.3
1970	55.2	7.2	1.1	2.1	5.7	5.1	1.0	6.2	12.7	2.2	7.5
1975	52.3	7.4	1.3	2.0	5.9	4.6	1.2	5.8	15.3	2.4	7.7
1980	47.6	6.9	1.1	2.2	5.5	5.0	1.2	6.2	19.4	2.9	8.1
1985	45.2	6.3	1.1	2.3	5.0	6.3	1.3	7.6	20.4	3.5	8.6
1986	44.8	6.1	1.1	2.6	4.7	6.9	1.4	8.3	20.1	3.5	8.7
1987	45.4	6.0	1.1	2.5	4.5	7.4	1.6	9.0	19.5	3.6	8.5
1988	45.1	6.0	1.0	2.4	4.3	8.3	1.7	9.9	19.1	3.6	8.5
1989	45.6	6.1	1.0	2.1	4.2	8.9	1.7	10.6	18.6	3.7	8.1
1990	45.7	6.2	1.0	1.8	4.3	9.4	1.8	11.2	18.0	3.8	8.0

Note: *Shinkin* are credit associations.
Shoko Chukin - Central Bank for Commercial and Industrial Cooperatives
Norinchukin - Central Cooperative Bank for Agriculture and Forestry
Postal funds cover the Postal Life Insurance (*Kampo*) and Postal Annuity systems.

Source: Compiled from data in Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 771.

declined since 1985, a development arguably reflecting the relatively slow growth of the government organizations financed by the trust fund.

Insurance Companies as Investors

The figures on insurance premiums suggest that insurance companies' policies, and often their salespeople as well, are to be found in virtually every home. In addition, insurance companies loom large in national financial markets as investors of funds. The essence of life insurers' business is to collect premiums, invest them and then return them to the policyholder in the event of premature death or at the policy's maturity. Because the interval between the payment of premiums and that of benefits may be decades, life insurance companies have the reputation in Japan, as they do in the United States, of being very long-term investors. As will be discussed further below, this gives them a valuable role in Japanese stock markets, where their patience is appreciated.

In the late 1980s financial institutions as a group held about 46 percent of the stock outstanding on Japanese stock exchanges. Of this, life insurance companies held about 20 percent of the total, and nonlife insurance companies another 3 percent. Japan's 12 nationwide commercial banks, known as city banks, held more stock per company than the 26 life insurance companies; moreover, holdings by all 154 Japanese banks were greater than those of life insurers. Nevertheless, life insurance company holdings were larger per institution than for the banking industry. Number-one Nippon Life was reported to account for about 3 percent of all stock-holding by itself.

Under the government's financial liberalization actions in the 1980s Japanese insurance companies were major beneficiaries with respect to their investment activities. One move significantly lifted caps on how much of the insurance companies' security portfolios could be allocated to foreign securities. For example, in August 1986 the Ministry of Finance permitted insurance companies to hold as much as 30 percent of their assets in foreign currencies. Insurance companies responded by increasing their overseas portfolios dramatically (see Table 2). Foreign securities grew from less than 0.05 percent of total assets in March 1973 to 13 percent in March 1991.

Table 2: **Composition of Assets of Japan's Insurance Industry, 1973-91**

(in billions of yen)

March 31	Foreign Securities	Total Assets	Foreign Securities as Percent of: Assets	Securities
1973	¥3	¥8,181	+0.0%	0.2%
1975	6	11,111	+0.0	0.2
1980	524	22,744	2.3	7.4
1981	669	26,258	2.5	8.4
1982	1,413	30,099	4.7	14.6
1983	2,169	34,614	6.3	19.2
1984	3,063	39,527	7.7	22.4
1985	4,029	45,740	8.9	25.1
1986	4,668	53,871	8.7	24.5
1987	7,525	65,317	11.5	28.1
1988	9,803	79,258	12.4	21.5
1989	13,596	97,083	14.0	30.4
1990	17,790	116,160	15.3	32.5
1991	16,985	130,251	13.0	29.4

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 754 and 756.

As values on the Tokyo Stock Exchange have plummeted this year Japanese insurance companies have attracted attention as a result of their important role as holders of stock. As will be shown below, they typically have held large shares of stock in other companies as a way of cementing business ties and directing those firms' business in their direction. Some analysts have worried, however, that the weakness of the Tokyo stock market may force insurers to sell a significant portion of their shares. Others have expressed the hope that insurance companies would buy more shares in an effort to buoy the market. However, Kenjiro Hata, chairman of Meiji Mutual Life Insurance Co. and head of Japan's life insurance trade association, appeared to disabuse both kinds of speculation at an early April news conference. He said, for example, that insurers would not request the government to raise current ceilings regarding securities holdings as a percentage of assets. He added that insurance companies would continue buying equities. Insurers admit, however, that they are adding less to their stock portfolios than they otherwise might.

Americans are particularly interested in Japanese life insurance companies' investments in this country. In the past 10 years these firms drew attention by purchasing both U.S. securities and real estate, with the latter often large city-center buildings, frequently called "trophy" properties. For example, Dai-Ichi Mutual Life Insurance Co. holds equity investments in Citicorp's two headquarters office buildings in New York City.

As the Japanese economy began to grow more slowly in 1991 and 1992 the growth rate of insurers' overseas assets also slowed, although total assets continued to increase. Japanese life insurance companies still provide little detail about their offshore activities, but they are somewhat more forthcoming than in the past. For example, Dai-Ichi's foreign equity holdings totaled ¥734 billion ($5.4 billion at ¥135=$1.00) as of March 31, 1991, up 12.2 percent from the year before. Its bond holdings, however, dropped 4.3 percent to ¥1.4 trillion ($10.4 billion). Overall, foreign investments increased 3.7 percent. This result suggests that, despite the concurrent weakness in the Japanese stock market, Dai-Ichi did not liquidate its overseas holdings. On the reasonable assumption that Dai-Ichi is typical, given the parallel actions that generally characterize Japanese life insurance companies, these figures suggest that the much-feared Japanese insurance company pull-out from foreign markets did not occur over that period.

Life insurance companies also have been called on to help bail out Japan's commercial banks since the Japanese stock market began declining in 1990. Like insurance companies, banks have seen their paper profits from stock investments decline sharply. Banks in Japan had been counting on using as much as 45 percent of these profits as capital to meet Bank for International Settlement requirements that they have capital equal to 8 percent of assets by March 31, 1993. As this means of achieving the goal has disappeared, banks have turned to the insurance companies for subordinated loans, another source of capital. Such loans are considered virtually the equivalent of equity since interest is paid only after other debt obligations are met. As a result, insurance companies typically demand a high interest rate. How life insurers will weigh the risk/return trade-off regarding subordinated loans remains to be seen, especially in light of their own weakened balance sheets and Ministry of Finance preliminary moves to tighten minimum capital standards for insurers themselves (see *JEI Report* No. 8A, February 28, 1992).

The Insurance Industry in Japan

Investments are possible, of course, only if insurers sell policies. In Japan as here many employees have life insurance through plans set up by their employers; other individuals purchase insurance from the thousands of door-to-door saleswomen employed by insurance concerns. Nonlife insurance companies provide many kinds of insurance to firms, such as hull insurance targeted toward shipping companies. Traditionally, business insurance was the most important product line for nonlife companies, but in the postwar period increasing amounts of insurance have been sold to individuals, especially the type of nonlife insurance that now represents the largest premium value — automobile insurance.

Rates for insurance in Japan are not necessarily set by market forces; sometimes they are determined through cooperative arrangements. For life insurance, administrative guidance from the Ministry of Finance traditionally has meant that rates vary little among insurers and that even the weakest companies survive. (This concept sometimes is called the "convoy approach.") One study has suggested that, at least for some kinds of life insurance, the Japanese industry is much more profitable than its U.S. counterpart. For example, the rate of return on a nonparticipating whole life product is said to be 8 percentage points higher in Japan than in this country.[1]

Nonlife insurance firms are required to belong to rating associations that fix rates for automobile and fire insurance; marine rates also are set cooperatively. The result is that Japanese nonlife companies typically have made profits, not just from their investments but from their underwriting activity as well; this situation puts them in an enviable position vis-a-vis their American counterparts. (The fiscal year that ended March 31, 1991 proved an exception, however, as most companies and the industry as a whole lost money on an underwriting basis.)

While the situation of the nonlife and life insurance industries would appear similar with respect to pricing, in fact it differs substantially. As joint stock companies nonlife firms presumably pay any extra profits from their cartel-like arrangement to stockholders, either directly in terms of higher dividends or indirectly in the form of a higher stock price. The market mechanism also works to monitor the companies' behavior. Better-managed companies will have a better stock performance, sending a signal concerning poorly managed companies to financial markets, policyholders and perhaps managements themselves.

Life insurance companies, which are mutual companies for the most part, typically have no stockholders. What then happens to any extra profits? Ryutaro Komiya, formerly of the University of Tokyo and now at Aoyama Gakuin University, suggests that employees and policyholders share the spoils.[2] Each year virtually every life insurance company pays its policyholders dividends that are based, in part, on the company's profit; these dividends average approximately 10 percent of annual insurance premiums, with some companies paying as much as 15 percent and others paying nothing. In addition, long-term policyholders typically get far more than short-term policyholders, although the actual formulas are very complicated. Moreover, firms that have a record of good management attract better employees since wages are higher. Hence, policyholders in better-run companies benefit directly from higher dividends and indirectly from more skilled employees.

One portion of dividends is called special dividends. Paid to long-term policyholders, these payments are among the few that the Ministry of Finance permits to be paid out of capital gains as opposed to current income. As long as the Japanese stock market rose regularly every year, companies easily could afford this obligation and tended to pay the same rate. However, as the stock market has declined in Japan, accumulated capital gains have diminished. Between September 1989 — when the market was close to its peak — and March 31, 1992 accumulated paper profits plunged from ¥47 trillion ($348 billion) to ¥10 trillion ($74 billion). They declined unevenly, however. Those insurance companies that grew more rapidly in the bull market of the late 1980s bought equities at higher average prices than companies that grew more slowly. Most observers speculate that small and medium-sized insurers have seen the sharpest declines in their paper profits, with a couple of Japan's 26 life insurance companies now having paper losses. In some contrast, the largest life insurance company, Nippon Life, saw its hidden profits decline from ¥11.2 trillion ($83 billion) to ¥3 trillion ($22 billion) over the same period, a somewhat smaller-than-average drop.

As a result of these differential changes in accumulated gains, Mr. Hata, the head of the life insurance trade association, admitted at his April news conference that a gap could open on special dividend rates. Other observers have speculated that industry reorganization could follow if the weakness of the stock market continues over the coming months and years.

These arguments suggest that MOF's efforts to standardize life insurance products and prices have not been entirely successful. However, policyholders have difficulty voting with their feet.

Since long-term policyholders are rewarded with larger dividends, switching is costly. In addition, the complexity of policies and the web of rules for dividend distribution aggravate determination of whether or not one is getting a generous dividend compared to one's neighbor or relative. In short, administrative guidance may not have eliminated those differences to which policyholders attach potential importance in choosing an insurer; however, policyholders have great difficulty obtaining relevant information or acting on it if they do obtain this input.

New Insurance Products and Trends

Like financial services industries elsewhere, the Japanese insurance industry has introduced a plethora of new products and services in recent years. Three broad types of products may be distinguished.

Savings Vehicles - Japanese life insurance companies, faced with mature markets for their traditional term and whole life products, have invaded areas that the banking industry regards as its turf. The battle among these titans is for the huge pool of Japanese savings. Smaller life insurance companies, such as Daido Mutual Insurance Co. and Chiyoda Mutual Life Insurance Co., for years have offered a type of highly liquid pension plan known as *kyosai nenkin* to employers terminating their in-house savings programs. Until 1989 the biggest insurers held back, reportedly reluctant to offend the largest banks, which regarded such programs as directly competitive. That year, however, large insurers, such as Nippon Life, entered the market in response to the rising share of savings attracted by these relatively small insurers.

Banks faced additional, substantial competition from another life insurance product. Single-premium endowment insurance, which comes with a fixed term, had attractive interest rates during the low interest rate era between 1987 and 1989, thereby attracting savings that otherwise probably would have gone to banks. In effect, this insurance policy was directly competitive with banks' long-term certificates of deposit; when interest rates on those bank products rose after 1989, insurance companies' business in savings-type products dropped sharply. In response, life insurers introduced single-premium variable endowment insurance in late 1990. This product, in which the yield depends on the investment performance of a portfolio of stocks and bonds, takes direct aim at the core business of brokerage firms. Securities companies howled, but their best defense, of sorts, has turned out to be the weak stock market, which has kept yields — and interest in the product — quite low.

Even nonlife companies have gotten into the chase for the unconsumed yen. In connection with fire insurance or accident insurance, for example, policyholders can opt to have what is called maturity-refund insurance. Under this program the insured takes out a policy for a fixed term of at least several years and gets savings plus interest on a portion of the premium payments. Approximately 10 percent usually goes toward the insurance, with the remainder allotted to the savings program. Like life insurers' fixed interest rate products, the maturity-refund programs boomed in the low interest rate era but have floundered as interest rates have risen since 1989.

In addition to trying to beat banks and brokerage firms for savers' deposits, insurance companies at times have joined with their competitors in introducing hybrid products. For example, as of January 1990 Meiji Mutual Life and Industrial Bank of Japan, Ltd. began offering a combination pension and interest-bearing bond product; the pension premiums were to be paid with interest from the bond. In addition, the product gave the policyholder comparatively easy emergency access to his or her funds.

Niche Products - As competition has increased in the insurance industry, companies increasingly have introduced products that, while not really substantively new, appeal to policyholders in special groups. Among the best-known of these is a nonlife product known as hole-in-one insurance. The policy pays off not as some sort of consolation prize for bad to middling golfers but to

those on whom fortune smiles. By tradition in Japan those golfers who achieve a hole in one incur huge expenses treating their companions; the insurance is to cover those costs. For the truly unlucky golfer nonlife firms offer insurance against being hit by errant balls. Another new niche product is insurance covering relatively short periods of time. For example, companies now offer insurance against a variety of accidents that could occur on a specific weekend trip.

Products and Services for the Elderly or Those Who Will Be - Japan's consciousness that the population is aging is progressing even faster than the actual process. Capitalizing on this new awareness, both life and nonlife insurance companies are marketing new products, not just to those who are already old but to people who may feel that they will have few family- or government-provided resources in their old age, which may be decades away.

Cancer insurance offered by American Family Life Assurance Co., a firm based in Columbus, Georgia, is one example of this kind of product. In the late 1980s both life and nonlife companies responded to increased fears about senility by offering dementia insurance; the insurance arm of the agriculture cooperative federation, *Zenkyoren*, has marketed a similar policy. The life insurance variant provides income in case of this disease; the nonlife version covers payments relating to treatment expenses.

Another product targets women. Given the fact that women typically are younger than their husbands in Japan and live to an older age, wives there (as in the United States) may expect many years of widowhood. One niche product is designed to supplement what many women apparently feel will be inadequate pensions after the death of a husband. Sales of such policies increased 40 percent last year compared to 1990.

In recent years companies have taken concern with the elderly a step further. This spring Nippon Life plans to open a 362-bed retirement home. (For details of aging and Japan's long-term care, see *JEI Report* No. 14A, April 10, 1992.) Nonlife insurance companies have moved recently to establish new subsidiaries that eventually may supply in-home nursing care and other medical needs. Their main initial purpose will be to provide medical advice and referrals by phone, although social workers in some instances will come to the home.

A potentially promising new area involves product liability insurance against lawsuits that a manufacturer or other firm may face. Japanese nonlife insurance firms are reacting with a combination of anticipation and dread to the possibility that Japan will enact legislation making such suits easier. They welcome the new business, of course, but look with horror at the many examples involving American companies. A recent example concerns Dow Corning Corp. and its insurers, which may face multimillion-dollar liabilities as a result of lawsuits concerning silicone-gel breast implants.

A few patterns stand out from this discussion of new products. Insurance companies are attempting to stake out claims to provide services that arguably are the natural domain of either banks or securities companies. In addition, life and nonlife insurance companies, whose businesses by law and tradition have been mutually exclusive, are competing with each other in an increasing number of areas. Both these trends suggest that the lines dividing industries are becoming increasingly blurred, a pattern that also has been observed in the United States. If anything, this development has taken longer to emerge in Japan than in this country. In a few instances U.S. companies, such as Equitable Life Assurance Co. of the United States and AFLAC, were able to tap their expertise in developing products for the American market in launching products in Japan, although, as will be shown below, U.S. companies have gained little in terms of market share as a result of these innovations.

Another pattern is increased competition. For insurers to be successful on bankers' turf, they have to offer superior products on favorable terms. The Ministry of Finance, which supervises both banks and insurance companies, cannot be expected to provide blanket protection to insurers in this situation. Further, many of the new products have yields tied to market performance and to fund

management skills. As these abilities inevitably differ among insurance companies, so, too, will yields. Hence, the insurance industry's cartel-like arrangement faces erosion, particularly with respect to life insurers.

As noted above, American insurance companies, banks and brokerage houses have been down this path already. Not too surprisingly, they have found it perilous in this country. As yields become more important to customers, both banks and insurance companies sometimes have been tempted to offer more than they can afford, resulting in problems. In particular, American investors in so-called guaranteed investment contracts have lost millions in forgone income when a few of the insurance companies that offered GICs were unable to pay the guaranteed rate.

Few observers believe that Japanese companies are in nearly so serious a situation. For one thing, many of their policies are still priced in a noncompetitive manner. However, recent rare losses by nonlife insurers on their underwriting business may be a shot across the bow, even though at the time the losses easily were offset by their investment business. Yet, for all the problems — real or prospective — of Japan's insurers, the Japanese insurance market rests securely in the world's number-two spot and is a tempting prize for entrants from other industries and for insurance companies based outside Japan.

Other Insurance Organizations in Japan

Alongside private life and nonlife insurance companies in Japan exists a variety of other insurance entities, typically parts of larger governmental or cooperative organizations. Some of these insurers are very large. For example, *Kampo*, the life insurance arm of the postal savings system, has more assets under its management than the combined assets of the top two private life insurance companies. Bureaucratically, *Kampo* is under the wing of the Ministry of Posts and Telecommunications rather than the Ministry of Finance, the regulator of life insurers. Between 1978 and 1988, the most recent year for which comparable data are available, *Kampo* policies in force increased by a factor of 1.8, almost identical to the 1.7-fold increase registered by private insurers; this suggests that *Kampo*'s share of the insurance market has been roughly constant.

Other important participants in the insurance market are the insurance arms of agricultural cooperatives; their nationwide organization is *Zenkyoren* (National Insurance Federation of Agricultural Cooperatives). *Zenkyoren* is involved in both life and nonlife insurance, with nonlife insurance being about three times larger. It is bigger than all but Nippon Life among Japanese insurance companies, making it one of the world's five largest insurers by some measures. Between 1979 and 1988, the most recent year for which data are available, *Zenkyoren* contracts outstanding grew 11.7 percent a year, faster than the 10 percent annual rate registered by life insurance companies or the 8.6 percent growth recorded by nonlife companies.

Until recently *Kampo* followed conservative investment philosophies, limiting the returns possible on savings-type products. In addition, the proportion of the population living in rural areas, *Kenkyoren*'s stronghold, has been declining. The ability of these two organizations to hold their own — and then some — in competition with private companies may reflect on the continued lack of competition among private insurers.

Foreign Insurance Companies in Japan

Foreign insurance companies have a long, if generally unremarkable, history in Japan. Both foreign life and nonlife companies date from the 1940s. American firms predominate among both types of companies (see Tables 3 and 4). American International Group's Japanese life insurance subsidiary, American Life Insurance Co., reigned as the biggest foreign life insurer until 1989. In that year AFLAC, which, as noted above, has carved out a niche in cancer insurance, became the largest foreign firm and the 18th largest among the 40 firms that sell life insurance in Japan. However, despite having 9 million policies outstanding, AFLAC's share of the total market is less than 1

Table 3: **Foreign Life Insurance Companies Operating in Japan***

Company	Year Licensed
American Companies	
Pioneer American Insurance Co.	1952
World Service Life Insurance Co. of Colorado	1953
American Life Insurance Co.	1954
Transamerica Occidental Life Insurance Co.	1955
American Amicable Life Insurance Co.	1957
Midland National Life Insurance Co.	1964
United of Omaha Life Insurance Co.	1964
American Defender Life Insurance Co., U.S.A.	1973
American Fidelity Life Insurance Co.	1973
First National Life Insurance Co. of America	1973
Old Republic Life Insurance Co.	1973
Trans World Assurance Co.	1973
United Services Life Insurance Co.	1973
American Family Life Assurance Co.	1974
Other Foreign Companies	
Nationale-Nederlanden Levensverzekering Maatschappij N.V. (Netherlands)	1986

*As of September 1, 1991.

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 860-867.

percent. (In addition to those companies listed in Table 3, four American insurance firms organized as Japanese companies have 0.4 percent of the total market.)

The situation is similar in nonlife insurance. For example, two companies affiliated with AIG, American Home Assurance Co. and AIU Insurance Co., collected 41 percent of all premiums paid to foreign nonlife insurance companies in the year ending March 31, 1991. In second place on this basis was CIGNA Insurance Co., which accounted for 38 percent, leaving only 21 percent for the remaining 32 American and other foreign nonlife insurance companies. All 35 foreign companies together collected only 1.2 percent of all nonlife premiums. (In addition, Allstate Insurance Co., which operates as a Japanese company, claimed a 0.2 percent share of the total market. Japan International Accident and Fire Insurance Co., another AIG subsidiary that began operations in 1989 as a Japanese company, so far has carved out 0.1 percent.)

In a sense the Japanese insurance market would seem to be made-to-order for invasion from abroad. It is profitable, Japanese competitors are regarded as conservative, and the market is growing. Yet American companies, which have earned their competitive wings in the tumultuous U.S. market, have made very limited progress. A number of explanations is possible.

- With the rules of competition essentially established, entrants are precluded from using one classic means of entry — low prices. Instead, they have tried another classic entree, new products. In the past, however, companies such as AFLAC have complained that the approval process has been lengthy, reducing potential profits and providing additional time for other entrants. In response, MOF defenders point to a simplifed approval process in recent years. They also note that MOF regulators have given foreign innovators a period during which they have enjoyed a monopoly,

Table 4: **Foreign Nonlife Insurance Companies Operating in Japan***

Company	Year Licensed
American Companies	
American Home Assurance Co.	1960
Continental Insurance Co.	1972
Federal Insurance Co.	1973
Travelers Indemnity Co.	1974
AIU Insurance Co.	1977
Lumbermen's Mutual Casualty Co.	1981
Transatlantic Reinsurance Co.	1981
CIGNA Insurance Co.	1985
Other Foreign Companies	
Alliance Assurance Co., Ltd. (U.K.)	1950
Commercial Union Assurance Co., P.L.C. (U.K.)	1950
Cornhill Insurance Public Limited Co. (U.K.)	1950
London Assurance (U.K.)	1950
New India Assurance Co., Ltd. (India)	1950
New Zealand Insurance Co., Ltd. (New Zealand)	1950
Northern Assurance Co., Ltd. (U.K.)	1950
Norwich Union Fire Insurance Society, Ltd. (U.K.)	1950
Phoenix Assurance Public Limited Co. (U.K.)	1950
Royal Exchange Assurance (U.K.)	1950
Eagle Star Insurance Co., Ltd. (U.K.)	1951
Assurance Generales de France I.A.R.T. (France)	1956
L'Union des Assurances de Paris I.A.R.D. (France)	1966
QBE Insurance (International) Ltd. (Australia)	1971
Royal Insurance Public Limited Co. (U.K.)	1975
Hyundai Marine and Fire Insurance Co., Ltd. (South Korea)	1976
Ansvar Mutual Insurance Co. (Sweden)	1979
Skandia International Insurance Corp. (Sweden)	1984
Malayan Insurance Co., Inc. (Philippines)	1985
Winterthur Swiss Insurance Co. (Switzerland)	1985
Zurich Insurance Co. (Switzerland)	1986
Assicurazioni Generali S.p.A. (Italy)	1987
Gan Incendie Accidents (France)	1988
General Accident Fire and Life Assurance Corp., P.L.C. (U.K.)	1988
Britannia Steam Ship Insurance Association Ltd. (U.K.)	1989
United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Ltd.	1989
Assuranceforeningen GARD-giensidig (Norway)	1991

*As of September 1, 1991.

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 868-891.

a policy akin to patent protection. As a result of such government practices, years after introducing its cancer insurance policy, AFLAC still has close to 90 percent of Japan's cancer insurance market.

- Distribution channels are a problem for insurance companies, as they are in other industries. Foreign firms generally feel they cannot afford to establish the network of housewives

selling insurance to other housewives, which is the accepted means of selling many kinds of insurance in Japan. American companies would like to establish agency procedures similar to those in the United States, in which a single insurance agent selects the most appropriate product and insurance company for his or her client and may handle lines from several insurance firms. So far U.S. insurers have made little progress in convincing the Ministry of Finance to permit this option.

Insurance and Keiretsu

In selling insurance packages to corporations foreign firms say they face a problem that overseas companies in other industries also have raised as an issue for government attention. Concerns about linkages associated with *keiretsu*, Japan's large corporate groups, are particularly severe in the case of insurance. Of the seven largest Japanese life insurance companies, all but Dai-Ichi Mutual Life are members of the president clubs of the six major *keiretsu* (see Table 5). The president clubs, which are organizations of 20 to 47 companies whose presidents meet as often as weekly, are considered by some analysts to be the inner circles of the most influential firms associated with Japan's large financial *keiretsu*, which are organized around banks. (For details of the *keiretsu* structure, see *JEI Report* No. 2A, January 12, 1990.) Many observers discount the importance of at least some of these linkages, however. Nippon Life, the nation's largest life insurer, has relationships with so many companies that its membership in the Sanwa Group, one of the weakest groups among the large *keiretsu*, may mean relatively little.

Table 5: **Japan's 10 Largest Life Insurance Companies and Keiretsu**

	Assets March 31, 1991 (in billions)	Market Share	President Club
Nippon Life Insurance Co.	¥27,441	21.1%	Sanwa
Dai-Ichi Mutual Life Insurance Co.	19,185	14.7	None
Sumitomo Life Insurance Co.	16,546	12.7	Sumitomo
Meiji Mutual Life Insurance Co.	11,301	8.7	Mitsubishi
Asahi Mutual Life Insurance Co.	8,816	6.8	Dai-Ichi
Mitsui Mutual Life Insurance Co.	7,082	5.4	Mitsui
Yasuda Mutual Life Insurance Co.	6,163	4.7	Fuyo
Chiyoda Mutual Life Insurance Co.	5,154	4.0	None
Taiyo Mutual Life Insurance Co.	4,844	3.7	None
Toho Mutual Life Insurance Co.	4,749	3.6	None
Total for President Club Members*	79,839	61.3	
Total for Industry	130,251	100.0	

*Includes total for Fukoku Mutual Life Insurance Co., a member of the Dai-Ichi President Club.

Source: *Toyo Keizai Geppo* and Ministry of Finance, *Hoken Nenkan (Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 203.

A similar situation exists with respect to nonlife companies. As shown in Table 6, the largest nonlife insurance companies are members of president clubs. In addition, their largest stockholder typically is a member of the same president club, an indication of the financial linkages that exist within a corporate group. While the next-largest companies usually are not members of a president club, their largest stockholder often is, tying them however indirectly to the group.

Table 6: **Japan's 10 Largest Nonlife Insurance Companies and Keiretsu**

	Assets/ (in billions) Share March 31, 1991	President Club	Largest Shareholder/ Its Membership
Tokio Marine & Fire Insurance Co., Ltd.	¥4,588 17.5%	Mitsubishi	Mitsubishi Bank, Ltd. Mitsubishi
Yasuda Fire & Marine Insurance Co., Ltd.	3,508 13.4%	Fuyo	Fuji Bank, Ltd. Fuyo
Mitsui Marine & Fire Insurance Co., Ltd.	2,385 9.1%	Mitsui	Mitsui Mutual Life Insurance Co. Mitsui
Sumitomo Marine & Fire Insurance Co., Ltd.	2,156 8.2%	Sumitomo	Sumitomo Trust & Banking Co., Ltd. Sumitomo
Nippon Fire & Marine Insurance Co, Ltd.	1,844 7.0%	None	Hitachi, Ltd. Sanwa and Dai-Ichi
Nichido Fire & Marine Insurance Co., Ltd.	1,648 6.3%	None	Fuji Bank, Ltd. Fuyo
Dai-Tokyo Fire & Marine Insurance Co., Ltd.	1,379 5.3%	None	Nomura Land and Building Co., Ltd. None
Koa Fire & Marine Insurance Co., Ltd.	1,140 4.4%	None	Nippon Express Co., Ltd. Sanwa, Dai-Ichi
Fuji Fire & Marine Insurance Co., Ltd.	1,132 4.3%	None	Daiwa Bank, Ltd. None
Chiyoda Fire & Marine Insurance Co., Ltd.	1,124 4.3%	None	Toyota Motor Corp. Mitsui
Total for President Club Members*	13,910 53.1%		

*Includes Nissan Fire & Marine Insurance Co., Ltd. and Taisei Fire & Marine Insurance Co., Ltd., both members of the Dai-Ichi President Club.

Source: *Toyo Keizai Geppo* and Ministry of Finance, *Hoken Nenkan (Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 414.

Although many American and Japanese economists minimize the importance of the *keiretsu* structure in limiting competition in Japan, its importance in the insurance industry arguably is greater than elsewhere as a result of the lack of competition. (For details of this debate with respect to the role of *keiretsu* in limiting market access for imported goods, see *JEI Report* No. 22A, June 14, 1991.) In the procurement of most goods and services companies may see little advantage in dealing with fellow *keiretsu* firms if such companies are uncompetitive. However, with competition in the Japanese

insurance industry severely limited, companies may gravitate toward their *keiretsu* life or nonlife insurance company. A 1987 report commissioned by Japan's Fair Trade Commission concluded that was the case in a comparison of corporate procurement practices of several manufactured goods and insurance services.

> As suggested by the above results, the reasons for choosing a supplier vary substantially by product. For facsimile machines and mainframe computers, product quality, in the broad sense, was given the most weight, followed by cost. Relationships with supplier companies were a minor factor. ...
>
> In contrast, group ties and fostering financial links were the primary factors determining the choice of pension fund placement and insurance suppliers, with 95.9 percent of respondents identifying one of these as the reason for choosing a pension fund manager and 75.3 percent identifying it as the primary factor in choosing their current insurance company. ...[3]

The report pointed out that life insurance companies and trust banks are the major managers of pension funds in Japan. It also noted that most of the companies surveyed by the FTC group had multiple suppliers of financial services. For smaller Japanese firms as well as foreign companies trying to sell insurance in Japan, the implication would appear to be obvious: the lack of competition in both types of insurance provides buyers an excuse to apply noncompetitive criteria in choosing their insurers.

Another characteristic of companies that belong to *keiretsu* president clubs is that participating firms hold stock in fellow *keiretsu* members. This means that big insurance companies may be large stockholders in their potential clients. (This pattern often exists even in the absence of a formal *keiretsu* structure.) Even without such positions, they simply may keep the business they already have as a result of the preference of Japanese companies for long-term relationships. In short, the argument that *keiretsu* act as an impediment to market access to U.S. firms may be stronger with respect to the insurance industry than it is for other industries.

Insurance as an International Economic Issue

The *keiretsu* connection has played an important role in turning Japan's insurance industry into a subject for talks between the United States and Japan. In recent years the industry has been a focus of at least two major series of negotiations.

In the ongoing discussions that follow up the 1989-90 Structural Impediments Initiative talks Washington has focused on the *keiretsu* structure as a trade barrier, thereby potentially raising the issue of the structure of the insurance industry. During a February meeting SII negotiators from both sides used the Japanese insurance industry as one of the case studies of the structural problems encountered by foreign companies trying to break into the Japanese market (see *JEI Report* No. 9B, March 6, 1992). A final list of new commitments from the Japanese side is expected this summer. Participants in the process emphasize that insurance per se has not been a subject of negotiation.

In a related development *Nihon Keizai Shimbun*, Japan's large economic daily, reported in mid-April that Washington has pressed Tokyo to make a public commitment to rectify problems that a July 1991 FTC-commissioned report identified concerning industries excluded from enforcement under the Antimonopoly Act. According to the FTC report, insurance industry practices — especially with regard to the pricing of marine and aviation insurance — are among the 41 legal exclusions from that act. Washington presumably wants Tokyo to legalize FTC antitrust action against insurance companies.

Further from the public eye, but arguably more important, are the talks concerning insurance in the Uruguay Round of multilateral trade negotiations (see *JEI Report* No. 8B, February 28, 1992). Japan, the United States and 106 other members of the General Agreements on Tariffs and Trade are involved in negotiations that began in late 1986 on a wide range of issues. Most public attention has focused on disagreements involving the United States, the European Community and — to a limited extent — Japan over agricultural issues, but the Uruguay Round covers many other areas as well.

The services sector, which includes insurance and other financial services, has its own set of concerns. The current draft text of a services agreement lays out broad principles that serve to guide negotiations in individual industries, such as insurance. From the U.S. perspective the key concepts are market access and national treatment (treating foreign concerns in the same way in which domestic companies are treated). However, participants in the Uruguay Round have not accepted this text.

Despite the uncertain foundation created by the failure to agree on an overall draft text, Japan, the United States and many other nations this year began what is known as a request-and-offer process regarding services. For example, in bilateral negotiations Washington has sought certain changes in Japan's insurance market and has asked Tokyo to identify what policies and practices in Japan might be inconsistent with GATT principles and open to negotiation. If the process goes as planned, Tokyo eventually will agree to a series of liberalizing measures reflecting negotiated agreements that balance requests from each of its partners with Tokyo's own offers. (In general, while both industrial and developing nations participate in the request-and-offer process, the negotiations involving the United States, the world's biggest market, obviously loom very large.)

Among specific U.S. complaints concerning the Japanese insurance market is Washington's argument that foreign insurance companies are more restricted concerning their investment activities in Japan than are domestic concerns — in short, a denial of national treatment. In addition, Washington has taken exception to Japan's restrictions concerning the use of insurance agencies. In the United States an individual seeking insurance can go to an agent who represents several companies. In Japan the agent is restricted to handling the business of only one company, thereby raising the question of whether market access is adequate for foreign companies inasmuch as their distribution costs are likely to be unusually high in the start-up phase. Somewhat the same problem exists with what are known as insurance brokers. In the United States brokers act as intermediaries on behalf of firms seeking insurance; they offer advice to clients and negotiate price with insurance companies. Brokers are not allowed in Japan.

Many issues still await resolution concerning international trade in insurance services. But even if the insurance talks eventually succeed, they could come to nothing if the Uruguay Round fails for other reasons. Given the lack of progress in agriculture and the busy 1992 political calendar, few observers expect that final approval of any agreement is likely before next spring, if then.

Conclusion

In Japan insurance industry practices sometimes are compared to a man with a hammer contemplating crossing a bridge. He hammers each stone, determining it to be solid, eventually reaching the middle of the bridge. Finding the middle stone solid as well, he proceeds back to the side from which he began. Today the Japanese industry faces a dilemma, perceiving the need to cross the bridge yet afraid that it might collapse under the industry's enormous weight. In some respects insurers so far have crossed the bridge halfway. Japanese government officials and insurance policyholders, as well as many insurance companies and policymakers abroad, are waiting to see whether Japan's reluctant insurance giants will continue toward the other side.

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Dan Levison provided research assistance.

Notes

[1]Allan D. Affleck and Stephen H. Conwill, "The Progress of Foreign Companies in the Japanese Life Insurance Market," *Japan Insurance News*, July/August 1991, p. 34.

[2]Ryutaro Komiya, *The Japanese Economy: Trade, Industry and Government* (Tokyo: University of Tokyo Press, 1990), pp. 233-264.

[3]Fair Trade Commission, *Long-Term Relationships Among Japanese Companies: A Report by the Study Group on Trade Frictions and Market Structure* (April 1987), pp. 6-7.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.